



Highlights & Analysis of the Governor's Budget

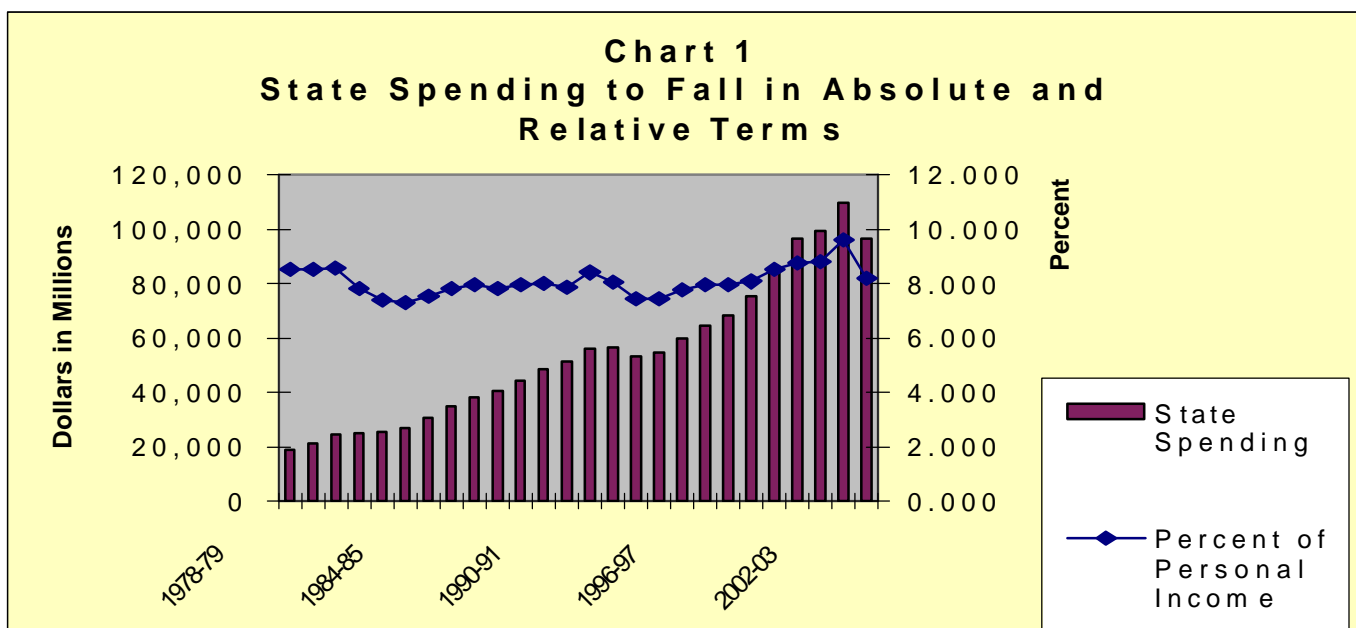
SENATE REPUBLICAN FISCAL OFFICE

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OVERVIEW

The Governor's Budget for 2003-04 proposes total state spending of \$96.4 billion (\$62.8 billion General Fund). This represents a reduction of \$13 billion from projected current-year total spending and of the same amount in General Fund spending. This year especially, it is important to look at total state spending (General Fund, select bond funds, and State Special Funds, exclusive of Federal Funds) because the tax increases proposed in the budget are to be deposited **not** into the General Fund, but into a new Special Fund.

Chart 1 puts the total state spending proposal into historical perspective. As the chart shows, the Budget proposes spending levels that represent the first reduction in absolute terms since the mid-1990's and which would break a 4-year upward trend in the percent of the state's economy (i.e., personal income) taken by state government. Even after this reduction, however, state government



will be spending 8.2 percent of total state personal income, a level comparable to what the state spent just prior to the enactment of Proposition 13.

While the Budget would appear to fully address the state's budget shortfall, it raises several significant issues, which are discussed briefly below.

Is the size of the shortfall exaggerated?

In November 2002 the Legislative Analyst's Office (LAO) estimated that the state faced a two-year shortfall of \$21.1 billion. The Governor's Budget identifies a shortfall of \$34.6 billion. The gap between these two estimates suggests that it is possible that the Budget has overstated the problem. The major differences between the two estimates are that the LAO has projected revenues that are about \$5.9 billion higher than what DOF is projecting and costs of about \$5.7 billion lower than those projected by DOF. To the extent that the LAO is correct, it could be possible, for example, to avoid entirely the two major tax increases proposed in the Budget and most of the cost-shifts to local government.

How severely will the tax increases affect the state's economic recovery?

The \$8.3 billion in tax increases included in the Budget will have a negative affect on the state's economy. Just how much of a drag is difficult to estimate. However, in April of 2000, Joe Fitz, Chief Economist with the State Board of Equalization prepared a report for Board Member Claude Parrish which outlined the potential impact of a sales tax increase. In his memo, Mr. Fitz estimated that for every 0.25 percent increase in sales tax, there would be a corresponding reduction in taxable sales of \$920 million. Given the Budget's reliance on a 1.0-percent sales tax increase, it is reasonable to assume that taxable sales will decrease by approximately \$3.7 billion. This will have a direct negative impact on jobs in California. Additional tax increases on tobacco products and permanent restoration of the ten and eleven percent income tax brackets will likely result in undeterminable job losses also.

The key to long-term revenue stability and growth is a healthy economy. Senate Republicans have therefore made it a priority to put a moratorium on job-killing legislation and to consider repeal of the more onerous bills.

Are the spending reductions proposed in the Budget "real"?

The Budget states that \$20.7 billion, or 59.9 percent of the "solutions" proposed to address the shortfall consist of various "cuts/savings". The two largest "cuts/savings" are the General Fund Savings from Realignment (which are entirely offset by tax increases) and a cost shift to local government. Moreover, some of the cuts/savings are the result of fee increases. Nevertheless, most of the cuts/savings are achievable if the legislature chooses to implement them. We discuss many of the specific proposals in more detail in the body of this report.

Does it solve the structural budget problem?

The Governor has stated that his budget will result in an operating surplus in 2004-05. The DOF has not yet provided any detail to support this assertion. It will be important to have the LAO's projections to evaluate the Governor's assertion. The Budget calls for a dialogue with the Legislature regarding possible structural reforms to prevent catastrophic budget crises in the future. The major component of any such reform must be a spending limitation with the "teeth" to prevent over-spending in the future.

TABLE OF CONTENTS

<u>TOPIC</u>	<u>CONSULTANT(S)</u>	<u>PAGE</u>
Economic Outlook	Tom Sheehy	1
State General Fund Revenue Forecast	Tom Sheehy	1
Tax Issues	Tom Sheehy	2
General Government	Tom Sheehy, Dave Harper	6
Local Government	Tom Sheehy	11
Realignment	Monica Allen	13
Health	Sharon Bishop	14
Human Services	Monica Allen	19
K-12 Education	Roger Mackensen	23
Higher Education	Roger Mackensen, Monica Allen	24
Public Safety and Judiciary	Dave Harper	27
Transportation, Resources, and Environment	Therese Tran	35

ECONOMIC OUTLOOK

National - A Modest Recovery

The National economy grew modestly in 2002. Real gross domestic product grew by 3 percent between the third quarter of 2001 and the third quarter of 2002. This output increase occurred despite very slow growth in employment and modest gains in personal income. Most of the recent growth in U.S. output has been driven by consumer spending and low interest rates have been the key to this strength. Low rates have boosted sales of automobiles and other interest-sensitive durable goods. Declining mortgage rates have also fueled new home sales and the refinancing of existing mortgages. New home construction adds directly to output. Refinancing has enabled individuals to reduce their home payments and cash out some of their built-up home equity. However, slow job growth, declining stock market values and other uncertainties are starting to take a toll on consumers. Many economists are concerned about how much longer consumer spending can sustain economic expansion. A slowdown in consumer spending would have major implications for the overall economy because consumer spending accounts for over two-thirds of economic output. Accordingly, the key to future economic growth appears to be increased business spending on capital equipment and labor. Significant business investment would provide a needed boost to income and jobs, which would in turn drive gains in consumer spending and overall economic growth.

California - Job Growth Hampered by Legislation

Like the rest of the nation, California had modest economic growth in 2002. Outside of the manufacturing and business services sectors, the California economy has recently grown at a moderate pace. The main positive forces have been low interest rates and continued California population growth. Non-business services employment is expanding modestly. However, the growth has not been large enough to create significant numbers of new jobs. Total California manufacturing employment has fallen by over 230,000 jobs (12 percent) since its peak in late 2000; one of the steepest two-year declines in the state's history. As with the nation generally, a key force behind the job losses in California's manufacturing and business services sectors has been the weakness in business investment spending. The decline is particularly important to California since so much of its high-tech goods and services are sold to businesses. Part of the problem in California is the enactment of recent laws increasing workers compensation benefits, repealing the 40-hour workweek flexibility, higher unemployment benefits and higher prices for electricity. These factors combined add higher costs and uncertainty to California's business sector. Furthermore, California manufacturers are also experiencing a plunge in foreign demand for their products. Total California-produced exports fell by 11 percent in 2001 and are forecast to decline 14 percent in 2002 due to soft economic conditions abroad. As with the national economy, future economic growth in California will require increased business investment. Without this, it is unlikely that California can sustain a meaningful expansion.

STATE GENERAL FUND REVENUE FORECAST

Softness in the California economy continues to take its toll on state revenues. The Budget estimates that past year and current year revenues are down by over \$7.7 billion compared

with the estimates used in the Budget Act of 2002. General Fund revenues are forecast at approximately \$4 billion less than the current fiscal year. The single biggest component being revised downward is the personal income tax which is forecast at almost \$5 billion less in the current year than the 2002 Budget Act assumed. This is attributable primarily to the continued deterioration in the stock market since last spring, which directly affects revenues from stock options and capital gains.

In the November 2002 "Fiscal Outlook", the Legislative Analyst's Office (LAO) stated that a delay in the economic recovery would significantly hurt the budget's revenue forecast. This could possibly result in several billion less in revenues than forecasted by the Governor.

The General Fund revenue estimate includes the following main components:

- **Personal Income Tax (PIT).** After increasing from \$16.3 billion in 1994-95 to \$44.6 billion in 2000-01, the budget forecasts PIT revenues in 2002-03 of only \$32.9 billion, or 26 percent less than its peak level. PIT revenue is forecast to grow slightly to \$33.6 billion in 2003-04. The steep decline from 2000-01 is related to both continued economic sluggishness and the adverse impacts of further stock market declines on taxable income related to stock options and capital gains.
- **Sales & Use Tax (SUT).** SUT is forecast at \$22.3 billion in 2002-03, a 4.6 percent increase from the prior year. 2003-04 SUT revenues are forecasted at \$23.2 billion, a 3.8 percent increase over the current year. Although SUT receipts are most generally associated with retail spending, approximately one-third of taxable sales are actually attributable to business-to-business transactions. These include purchases of computers, telecommunications equipment, and building materials that go into the construction of new facilities. Resurgence of business investment will play a key role in the growth of this source of state income.
- **Bank and Corporate Tax (BCT).** BCT is forecast at \$6.5 billion in 2002-03, a 39 percent increase from the prior year. 2003-04 BCT revenues are forecasted at \$6.3 billion, a 2.8 percent decrease over the current year. The two-year suspension of NOL, along with other tax-related law changes enacted in 2002-03, will boost the BCT by \$1.2 billion in the current year and about \$540 million in 2003-04. In subsequent years, receipts will be reduced by between \$250 million to \$400 million annually, reflecting the increase in allowable NOL deductions from 65 percent to 100 percent of incurred losses beginning in 2004.

TAX ISSUES

The Governor's Budget proposes major tax increases. The additional tax burden, if enacted, is sure to further slow California's economic recovery. The bulk of the tax increase revenues (\$8.4 billion) will be deposited into special funds targeted at supporting the proposed realignment proposal (see below). The balance of the tax increases (approximately \$100 million) will be deposited into the General Fund and are reflected in the new revenue estimates.

The major tax increase provisions include the following:

- **Restoration of the 10 percent and 11 percent Income Tax Brackets - \$2.6 billion.** This proposal would add a 10-percent personal income tax rate for incomes above \$136,115 for single filers and an 11-percent rate for incomes above \$272,230 for single filers (these figures double for married filers). These income levels are the same as the higher rates that were added during the fiscal crisis of the early 1990s, adjusted for inflation. Because State-Local Program Realignment is intended to be permanent, these higher rates are also permanent. The PIT revenues would be deposited into a special realignment fund, with the amount to be adjusted two years in arrears to ensure that the amounts deposited are not more or less than the costs of the programs to be realigned.
- **One-cent Sales Tax Increase - \$4.6 billion.** This proposal would result in a permanent one-cent increase in the sales tax rate. This tax increase will have a direct negative impact on consumption in the state and thereby further jeopardize a weak economic recovery. These revenues would also be deposited into the special realignment fund.
- **\$1.10 Per Pack Tobacco Increase - \$1.2 billion.** The State-Local Program Realignment proposes a tobacco tax increase of \$1.10 per pack. The tobacco tax portion of realignment is expected to provide \$1.17 billion in revenues to local governments in 2003-04 and \$1.073 billion in 2004-05. Because this increase is expected to reduce consumption by an additional 11 percent, the existing special funds that receive tobacco tax revenues will experience a reduction of approximately \$96 million in 2003-04 (-\$31 million Proposition 99, -\$62 million Proposition 10, and -\$2.5 million Breast Cancer). These losses will be back-filled from the revenues generated by the increased tax.

The Budget includes additional tax provisions as follows:

- **Regulated Investment Companies.** The Budget proposes to prevent banks from utilizing Regulated Investment Companies (RIC) to avoid California tax by improperly sheltering income. The proposal would be implemented prospectively, and is estimated to increase revenues by \$45 million in 2003-04 and \$55 million in 2004-05. A RIC is a mutual fund or real estate investment trust that is eligible to pass the taxes on capital gains, dividends, or interest payments on to the clients or individual investors. RICs are exempt from paying federal and state income taxes.
- **Corporation Tax Subpart F Income Exclusion.** The Budget proposes to clarify that existing law does not allow certain corporations to exclude a portion of their income, called Subpart F income, from a water's edge combined report. The Budget also proposes to conform to federal law in the coordination of Subpart F income and U.S.-source income. Because these proposals would clarify existing law, they will have no effect on revenues. However, these changes will close potential tax loopholes.
- **Manufacturers' Investment Credit (MIC) Clarification.** The Budget proposes clarifying that the MIC is intended to apply to manufacturing activities as specified in the Standard Industrial Code. This proposal would increase revenues by an estimated \$50 million in 2003-04 and \$50 million in 2004-05.
- **Extension of the Sunset Provision for the Manufacturers' Investment Credit (MIC).** Based on the Budget's economic forecast, decreases in manufacturing employment are expected to cause the MIC to sunset on January 1, 2004. Chapter 751, Statutes of 1994, which established the MIC to create manufacturing jobs, provided that the credit would sunset if

manufacturing employment does not exceed a specified level. Although under current law the MIC would sunset, the Budget proposes to revise the MIC provisions and extend the sunset date in order to continue the stimulus this credit provides for jobs and investment, thereby assisting the economic recovery.

- **Real Estate Withholding Modification.** Chapter 488, Statutes of 2002, included provisions that require withholding for commercial real estate sales by California residents (non-residents were already subject to withholding). Apartments and other business property (such as rental homes) are included, but second homes are not included. Chapter 488 required withholding of 3.33 percent of the sales price. The Budget proposes to modify these requirements to allow the option of withholding either 3.33 percent of the sales price or 9.3 percent of the gain. This proposal would mitigate the burden of this program on individuals who may owe less tax than would be withheld under Chapter 488. This proposal is estimated to reduce the revenue increase from Chapter 488 by \$30 million from \$225 million to \$195 million in 2002-03.
- **Vehicle License Fee (VLF) Backfill.** This is NOT a direct tax increase. The Budget does not propose to increase the VLF back to the old rate. Rather, it proposes to eliminate the backfill from the General Fund to local governments, effective February 1, 2003. As a result, local governments would suffer a loss of about \$2.9 billion annually. We believe, however, that eliminating the back-fill might set the stage for State Controller to use existing statutory law to invoke a provision in the Revenue and Taxation code providing that the VLF offsets can be eliminated when there are “insufficient” funds available.
- **Indian Gaming Revenue - \$1.5 Billion.** In 1999, the State entered into Tribal-State Gaming Compacts with 61 federally recognized Indian tribes. These compacts can be opened for renegotiations in 2003. Additionally, there are a number of “non-compact” tribes that have indicated an interest in negotiating for new gaming compacts.

The Budget anticipates that negotiations with the existing compact tribes, as well as the current “non-compact” tribes, will result in a revenue sharing agreement that will generate \$1.5 billion in additional revenue to the General Fund.

- **Fee Increases.** In addition to the tax increase proposals, the Budget includes over one billion dollars in new fee increases. These fee increases will directly impact consumers and businesses in the state and are described more fully in this report.

The following charts summarize the tax and fee revenue increases included in the budget.

Provision	2002-03	2003-04
(\$'s in millions)		
Explicit Tax Increases		
10% / 11% Bracket	---	\$2,580
1 Cent Sales Tax	---	\$4,584
\$1.10 Tobacco Tax	---	\$1,170
RICs	---	\$45
MIC clarification	---	\$50
Indian Compact	---	\$1,500
Potential Tax Increase		
VLF backfill	\$1,265	\$2,929
Various Fee Increases	\$10	\$1,259
Total	\$1,275	\$14,117

Fee Increases	2002-03	2003-04
(\$'s in millions)		
U. C. – Resident, Undergraduate Fees	---	\$394.0
C.S.U. – Resident, Undergraduate Fees	---	\$303.0
Community Colleges – Unit Fee Increase	---	\$149.0
Motor Vehicle Account	---	\$193.0
D.I.R. – Workers' Compensation Program	---	\$73.7
Trial Courts - Various	---	\$66.2
Restitution Fund	\$10.0	\$27.0
Waste Discharge	---	\$13.6
Stationary Source of Air Pollution	---	\$10.0
Youth Authority – Sliding Scale inflation adjustment	---	\$7.1
Pesticide Sales – Mill assessment	---	\$7.5
Community Care Licensing – Facility Fee Increase		\$6.8
Pesticide Regulation licensing/exam.	---	\$1.1
Judiciary – Appellate Filing Fee	---	\$2.1
Veteran's Affairs – Residential Care Units	---	\$1.2
I.H.S.S. – Provider Rate Increases	---	\$2.8
H.C.D. – Farm Worker / Migrant Service Center rent increase	---	\$1.3
Total	\$10.0	\$1,259.4

Reserve For Economic Uncertainty

The Governor's Budget assumes an ending reserve for the 2002-03 fiscal year of -\$5.6 billion and a small reserve of only \$531 for fiscal year 2003-04 ending June 30th, 2004.

GENERAL GOVERNMENT

STATEWIDE ISSUES

Reduction in State Operations - \$320.8 million

Chapter 1023, Statutes of 2002, added Control Section 3.90 to the 2002 Budget Act, authorizing up to a 5 percent reduction of State operations appropriations to reflect a total reduction of \$750 million. However, the State has only achieved a portion of the \$750 million savings target. In his mid-year reduction package, the Governor proposed \$320.8 million in General Fund reductions to State operations pursuant to Chapter 1023. In other words, the budget reflects only \$320.8 million in savings out of the \$750 assumed in the Budget Act of 2002. To achieve these savings, the Administration is proposing reversion items to capture the savings. Budgets for state operations will be reduced, and General Fund savings achieved through various actions including:

- Reductions in specific program areas
- Shifts in program funding
- Reductions and elimination in operating expenses for non-essential activities (e.g., out-of-state travel, training, equipment purchases, etc.)
- Increases in federal funds
- Elimination of departments/programs
- Prior years savings

Position Elimination

The Budget proposes to eliminate a net of 1,900 positions for the 2003-04 fiscal year resulting in over \$100 million in state savings. The Administration estimates that approximately 1,500 of these positions are currently filled and, as a result, layoffs are likely to achieve the reductions / savings. The elimination of these positions is in addition to the approximately 12,600 vacant positions eliminated over the last three years in response to the Senate Republican Caucus analysis of the "Budget Shell" game and excess vacant positions in state government. Of these vacant positions, 6,000 were eliminated as part of the Budget Act of 2002 at the insistence of Senate Republicans.

Capital Outlay

The Budget proposes \$1.9 billion in capital outlay expenditures for 2003-04, exclusive of K-12 schools, transportation and state conservancies. Of this amount, \$954 million is for the continuing phases of previously approved projects and \$1 billion is for new projects. Funding for this program comes from multiple fund sources including General Fund, federal funds, bond funds and various special funds.

General Obligation Bonds

California currently owes \$22.7 billion in principal on outstanding non-self liquidating general obligation (GO) bonds as of the end of calendar year 2002. The General Fund cost for the payment of interest and redemption on these bonds is \$1.7 billion in 2002-03 and is estimated at \$1.9 billion in 2003-04. In addition, in November 2002, the voters approved approximately \$18 billion in new bond authority for school, water and housing bonds.

Lease-Revenue Bonds

The State also uses lease-revenue bonds to supplement the GO bond program. Outstanding lease-revenue bonds totaled \$6.3 billion as of September 1, 2002, and are estimated to total \$6.6 billion as of June 30, 2003, and \$6.9 billion as of June 30, 2004. The General Fund cost for lease payments (principal and interest) was \$525.7 million in 2001-02 and is estimated to be \$547.5 million in 2002-03 and \$571.5 million in 2003-04.

State Employer Retirement Contributions

The Budget proposes legislation to authorize Pension Obligation Bonds to fund the State's 2003-04 retirement contribution to both the California Public Retirement System (CalPERS) and the State Teacher's Retirement System (STRS). Generally, Pension Obligation Bonds are a method of funding a system's unfunded actuarial liability.

Simultaneously, the Administration will be entering into discussions with the CalPERS and STRS boards to explore the possibility of a loan, as part of each system's fixed-income investment portfolio, to pay the 2003-04 State employer contributions. Assuming one of these proposals will ultimately be adopted, the Governor's Budget reflects a one-time General Fund saving of \$1.5 billion for the 2003-04 fiscal year (\$1.1 billion for CalPERS and \$400 million for STRS).

In addition, the Budget reflects the following Governor's Mid-year Spending Reduction Proposals:

- **STRS** – A one-time \$500 million (General Fund) savings from eliminating the July 2003 state contribution to the Supplemental Benefit Maintenance Account (SBMA) in the State Teacher's Retirement Fund. This account is designed to provide purchasing-power protection to retired teachers. The State is statutorily required to make annual General Fund payments to the SBMA equal to 2.5 percent of teachers' salaries, estimated to be \$555 million in 2003-04. The Administration proposes that this payment be reduced by \$500 million, coupled with a statutory commitment to restore the funds if purchasing power protection at the 80 percent level cannot be maintained through July 1, 2036. Based on advice from the State Teachers' Retirement System, this proposal will not affect the ability to provide the purchasing-power protection for at least 30 years.
- **Employee Compensation.** A savings of \$854 million (\$470 million General Fund) in state employee compensation which potentially could be achieved through the elimination of scheduled pay increases, salary reductions, benefit reductions and/or layoffs.

DEPARTMENTAL ISSUES

Office of Planning and Research

The Governor's Mid-year Spending Reduction Proposal would reduce the Cesar Chavez Grant program by \$4.75 million to suspend this program for three years beginning in 2003-04.

Information Technology

The Department of Information Technology was abolished effective July 1, 2002. The Budget includes \$2 million General Fund for the Department of Finance to continue information technology oversight as the state evaluates how the new IT governance structure should be implemented.

Franchise Tax Board

The budget reflects savings of \$1.4 million and 50 personnel years from increased electronically filed tax returns.

Department of General Services

- The Governor's Mid-year Spending Reduction Proposal would reduce \$609,000 by realizing construction bid savings for the Norco-Administration Building 100-Occupant Relocation.
- The Budget includes a \$22 million reduction to reduce operating expenses, overhead and related staff positions

Department of Corporations

The Budget proposes to consolidate the Office of Real Estate Appraisers with the Department of Corporations effective July 1, 2003. No specific savings are identified with this consolidation.

Department of Housing and Community Development

The Governor's Mid-year Spending Reduction Proposal included the following adjustments totaling \$38.1 million in reductions / General Fund savings:

- **Shift of Farmworker Housing Grants to Bond Funds.** With the passage of Proposition 46, the Housing and Emergency Shelter Trust Fund Act of 2002, the Budget proposes that General Fund supported projects now be funded from bond funds, resulting in savings to the General Fund of nearly \$11.0 million.
- **Homeless Shelter Operations Funding.** The historic level of State funding for homeless shelter operations has been \$4.0 million. This proposal would reduce the funding by \$1.3 million in 2002-03.
- **Transfers to the General Fund.** The Budget proposes that \$5.5 million in funds previously appropriated for Self-Help housing projects be returned to the General Fund. Also, \$1.9 million will be returned to the General Fund from the Predevelopment Loan Fund.
- **Loans to the General Fund.** The Budget proposes loans to the General Fund of \$18.1 million from the balances of seven special funds where those funds are not currently pledged to projects.

- **Other State Operations Reductions.** The Budget proposes three expenditure reductions that will result in savings to the General Fund of \$288,000.
- **Passage of Proposition 46 Increases General Fund Transfers.** The passage of Proposition 46 triggers budget control language that increases transfers to the General Fund as follows:
 - An additional transfer of \$5,599,000 from the Self-Help Housing Fund.
 - An additional \$2,999,000 from the Farmworker Housing Grant Fund.

Additional proposals in the January 10, 2003 version of the budget include:

- Fee increases for the Farm Worker Housing Program totaling \$721,000
- Fee increases for the Migrant Services Center totaling \$625,000

Office of Real Estate Appraisers

The Governor's Mid-year Spending Reduction Proposal includes a loan to the General Fund of \$1 million from the Real Estate Appraisers Regulation Fund reserve.

Technology, Trade and Commerce Agency

The Governor's Mid-year Spending Reduction Proposal included the following adjustments totaling \$13.5 million in reductions / General Fund savings:

- **Reimbursements of Film Production Costs.** The Film California First program reimburses state and local agencies for costs they incur for television and film productions in their jurisdictions. The Administration proposes a reduction of \$2.1 million to this amount.
- **Biomass Funding.** The Administration proposes eliminating the third year of program funding, resulting in a savings to the General Fund of \$4 million.
- **Loans to the General Fund.** The Administration proposes loans to the General Fund totaling \$6.2 million from the balances of two special funds where those funds are not currently pledged to projects.
- **Return Funding to the General Fund.** The Administration proposes six expenditure reductions that will result in savings to the General Fund of about \$1.2 million.

Additional proposals in the budget include:

- A \$6.5 million General Fund reduction resulting in the elimination of the state funding for the California Technology Investment Program (Cal-TIP), the manufacturing investment program, the Space and Technology Alliance Program and the associated staff support in these areas.
- An \$8.1 million General Fund reduction in support of various economic development programs including Military Base Reuse and Retention, Small Business Development Centers, Film California First, and other business development programs.
- A \$7.5 million General Fund reduction reflecting the elimination of the Tourism Division.

- Other miscellaneous reductions totaling \$1.7 million and a reduction of 146 positions conforming to the reduced program level in the Agency.

California Arts Council

The Governor's Mid-year Spending Reduction Proposal includes a \$1.2 million reduction in local grant funds to assist art programs, artists, and local arts councils, and \$112,000 for related state operations expenditure reductions.

- **Employee Compensation** – A savings of \$854 million (\$470 million General Fund) in state employee compensation which potentially could be achieved through the elimination of scheduled pay increases, salary reductions, benefit reductions and/or layoffs.

Department of Personnel Administration (DPA) – The Budget proposes to reduce total funding for the DPA by approximately \$19 million (\$17 million General Fund). Approximately \$11.5 million of this reduction is from the Governor's Mid-year Spending Reduction Proposal to eliminate the annuitant component of the Rural Health Care Equity Program. However, the Budget includes a General Fund augmentation of approximately \$1.8 million and 29 positions to handle the increased workload resulting from planned statewide layoffs.

California Victim Compensation and Government Claims Board (Board) – The Board's primary role is to compensate victims of violent crime for certain crime-related financial costs. Compensation for the victims comes primarily from the Restitution Fund and the two major sources of revenue to the Restitution Fund are penalties on felony convictions and federal funds. Due to program expansions and an aggressive marketing campaign that resulted in application increases, the Restitution Fund has been experiencing an operating deficit in the range of \$27 to \$40 million over the past two fiscal years.

To solve this problem, the Budget proposes **a \$37 Million fee increase**, with \$10 million being received in the 2002-03 fiscal year and \$27 million being received in the 2003-04 fiscal year. The specifics of the proposal are not yet available, but generally, the additional revenues are from increasing the minimum restitution fine, adding a \$100 surcharge on the re-issuance of a driver's license that has been suspended for a "drug or alcohol related" conviction, and increasing the amount of money withheld from Inmate Trust Accounts from 20 percent up to 50 percent.

Industrial Relations

The Budget proposes \$244.5 million for Industrial Relations in 2003-04.

- **Workers' Compensation Funding Increase and New Positions.** The Budget increases funding by \$9.2 million and 68 personnel years to implement AB 749 (Chapter 6, Statutes of 2002). AB 749 increased workers compensation benefits and made structural reforms. Although many of the new positions are federally funded, the establishment of new positions increases the size of an already excessive state bureaucracy. Further, if the Governor extends his current hiring freeze beyond June 30, 2003, the Department of

Industrial Relations may experience significant difficulty in filling the positions and may eventually lose them.

- **New Fees.** The Budget proposes to shift 100 percent of funding to employers for workers' compensation programs, generating \$73.7 million in General Fund savings for 2003-04 (Governor's 2002 Mid-year Spending Reduction Proposal).

Veterans Affairs

- **Fee Increases.** The Budget increases fees for members in residential care units of veterans homes, generating an estimated \$1.15 million in General Fund savings for 2003-04.

Commission on State Mandates

The Governor's Mid-year Spending Reduction Proposal would continue the suspension of payment for various budget-year and prior year reimbursable non-Proposition 98 mandates, resulting in savings of \$769.4 million in 2003-04.

LOCAL GOVERNMENT

By far, the most significant local government issue is the Governor's State / Local Realignment proposal described below. In addition to the restructuring proposal, there are various other budget proposals having a direct impact on local government. These include:

- **Transfer of Unencumbered Low and Moderate Income Housing Funds to the State.** The Governor's Mid-year Spending Reduction Proposal would shift up to \$500 million in annual property tax increment to the General Fund. Community Redevelopment Agencies are required to transfer at least 20 percent of their annual property tax increment into the Low and Moderate Income Housing Fund for the purposes of increasing, improving, and preserving low- and moderate-income housing. An estimated \$500 million of this property tax revenue remains unutilized. The Administration proposed in December that Community Redevelopment Agencies be required to immediately transfer any balances in their Low and Moderate Income Housing Funds that were unencumbered on December 1, 2002, to the State Controller for deposit into the General Fund. The January version of the budget still includes this proposal but modifies it to become an ERAF like shift. This will result in net savings of approximately \$460 million to the State.
- **School District Redevelopment Increment.** In addition to taking the Low and Moderate Income Housing Fund balances, the Budget proposes to capture \$250 million in redevelopment property tax increment in 2003-04 and redirect those funds into local schools. The proposal would increase this redirection over several years to approximately \$900 million annually.

- **VLF Backfill.** The Budget proposes to eliminate the VLF backfill to cities and counties effective February 1, 2003 for a current year savings of \$1.27 billion and budget year savings of \$2.9 billion. The backfill related to the early 1990's realignment and VLF fees related to Orange County debt repayment are not affected by this proposal.
- **Williamson Act Subvention.** The Budget proposes to eliminate the Williamson Act subvention effective July 1, 2003. This action will save the General Fund \$39 million.
- **Booking Fees.** The Budget proposes to eliminate the \$38.2 million General Fund backfill of booking fees allocated to city police chiefs.

In addition to the afore-mentioned policy decisions that directly impact local governments, the Budget contains various other "cost shifts" or local assistance grant reductions, including:

- **Vertical Prosecution of Spousal Abuse.** The Budget proposes a General Fund reduction of \$3 million due to the elimination of the program to assist district attorneys in the vertical prosecution of spousal abuse.
- **Gang Prevention Grants.** The Budget proposes a General Fund reduction of \$3 million due to the elimination of grants to support gang prevention activities.
- **State Crime Lab Fee.** The Budget proposes to charge local agencies a portion of the costs for processing and analyzing physical evidence in State Crime Labs, for an estimated General Fund savings of \$3.5 million.
- **Sliding Scale Fee Increase at the Youth Authority.** The Budget proposes to implement a \$7.1 million inflation adjustment to the sliding scale fee that the Youth Authority charges to counties for various juvenile commitments.
- **Local Police Officer Training Reimbursement.** The Budget proposes to save \$28.3 million by eliminating a program that partially reimburses local law enforcement agencies for the cost of student travel and per diem and reimbursement of overtime to replace line officers during training.
- **Local Correctional Officer Training Reimbursement.** The Budget proposes to save \$17 million from the elimination of partial reimbursement for tuition, travel, per diem, and staff replacement costs for training local correctional officers. The portion of local correctional officer training costs currently paid for by the State will now become the responsibility of local correctional agencies.
- **Various Local Assistance Grants from the Office of Criminal Justice Planning.** The Budget proposes a General Fund reduction of \$3.4 million associated with various public safety local assistance programs detailed under the Office of Criminal Justice and Planning.

REALIGNMENT

The 2003-04 Budget shifts responsibility for several health, human services, and court programs from the state to counties. In addition, the Budget proposes tax increases to provide revenues for counties to administer the realigned programs. The table below summarizes the proposal.

(Dollars in Billions)

Revenue Sources		2003-04 Estimated Revenue
Source		Amount
One-Cent Sales Tax Increase		\$4.584
10 and 11 Percent Income Tax Brackets Addition		\$2.580
\$1.10 Tobacco Tax Increase		\$1.170
Total		\$8.334
Realigned Programs	2003-04 General Fund Savings	2003-04 County Costs
Program Area	Amount	Amount
Mental Health and Substance Abuse	\$0.306	\$0.305
Children and Youth	\$2.307	\$2.370
Healthy Communities	\$2.671	\$2.727
Long-Term Care	\$2.571	\$2.571
Court Security	\$0.300	\$0.300
Total	\$8.154	\$8.273

The proposed realignment raises several major fiscal policy issues, which will need to be resolved before the Legislature acts on the proposal:

- Is the funding to be transferred to local government proportionate to the costs being shifted?
- How will funding levels be adjusted in future years?
- How much flexibility will local government be given to control future costs?

HEALTH

For 2003-04, expenditures for all Health and Human Services Agency budgets total \$61.4 billion in combined state and federal funds. General Fund expenditures for Health and Human services are projected to be \$15.2 billion (down from \$23 billion in 2002-03), which represents 24.1 percent of the state budget. This significant decline in expenditures is the result of the Governor's Realignment Proposal. For example, the proposed budget for the Department of Health Services (including Medi-Cal and Public Health) is \$27.7 billion (\$7.6 billion General Fund), which reflects a General Fund decrease of \$3 billion. And although the budget for the Department of Mental Health includes an overall net increase of \$206.8 million, it includes a General Fund reduction of \$33.4 million.

Medi-Cal

The Medi-Cal caseload is expected to decline in 2003-04 by 3.2 percent to 6,268,200 eligibles. Medi-Cal spending is projected to be \$24.7 billion (\$7 billion General Fund), which is 28.9 percent below the 2002 Budget Act. This huge reduction is of concern because it is achieved with the elimination of 18 of the 34 optional benefits, a 15 percent cut in provider rates, elimination of the Wage Adjustment Rate Program that provides a supplemental payment to long-term care facilities, various eligibility expansion rescissions, and realignment of some expenditures. (As noted below in more detail, most of these reductions were initiated to a lesser extent in the Governor's Mid-year Spending Reduction Proposals).

It is also important to note that the budget for Medi-Cal continues to provide funding for several recent program expansions that were approved despite serious fiscal concerns. These programs are described at the end of this section.

- **Optional Benefits.** The budget proposes to eliminate 18 optional benefits for savings of \$723.7 million (\$361.8 million General Fund) in 2003-04. [The Governor's Mid-year Spending Reduction Proposals package proposes the elimination of 10 of these optional benefits, effective April 1, 2003, for current-year savings of \$126.5 million (\$63.3 million General Fund)]. The following is a breakdown of the specific benefits proposed for elimination and the associated savings of each. The budget does assume that some cost shifting to mandated services will occur.

Optional Benefits to be Eliminated

Benefit	General Fund Savings in 2003-04 (\$ in millions)
Cuts Proposed in December 2002 to be effective April 1, 2003:	
Adult Dental Services	\$211.80
Medical Supplies	54.30
Podiatry	4.30
Acupuncture	2.90
Chiropractic Services	.40
Psychology	.20
Independent Rehabilitation Centers	.02
Occupational Therapy	.15
Additional Cuts Proposed for 2003-04:	
Non-Emergency Medical Transportation	31.50
Optician/Optical Lab Services	14.50
Hospice	13.70
Durable Medical Equipment	12.50
Optometry	9.20
Hearing Aids	2.90
Prosthetics	2.10
Speech/Audiology Services	.70
Orthotics	.60
Physical Therapy	.03
TOTAL SAVINGS	
	\$361.80

- **Provider Rate Cuts.** The Budget proposes a total reduction of 15 percent in the rates paid for most Medi-Cal services, for savings of \$1,427.6 million (\$720.5 million General Fund) in 2003-04. The Governor's Mid-year Spending Reduction Proposals package proposes a 10 percent reduction, effective April 1, 2003, for current-year savings of \$185.3 million (\$90.4 million General Fund). The Governor's budget proposal exempts inpatient and outpatient services, federally qualified health clinics, and rural health clinics from these reductions. It is important to note that Republican legislators have worked hard over the past several years to improve access to health care for those covered under government health insurance programs by supporting higher Medi-Cal reimbursement rates in an effort to gain and retain medical services providers.
- **Prospective Curbs on Eligibility.** The Budget proposes a share-of-cost requirement for those aged and disabled Medi-Cal beneficiaries whose incomes are between the SSI/SSP benefit level and 133 percent of the federal poverty level, for savings of \$127.6 million

(\$63.8 million General Fund). A second proposal rescinds the March 2000 expansion of the 1931 (b) Program that allows certain parents of eligible children to enroll in Medi-Cal, for savings of \$236 million (\$118 million General Fund) in 2003-04, although it continues eligibility for the 230,000 already enrolled. The Governor's Mid-year Spending Reduction Proposals package proposes this same rescission, effective April 1, 2003, for current-year savings of \$12.4 million (\$6.2 million General Fund). A third proposal eliminates the state-only program that provides a **second** year of transitional Medi-Cal benefits for families who leave welfare. This program would be eliminated on October 1, 2003, which would result in General Fund savings of \$2 million in the budget year.

- **Realignment.** The Budget proposes that counties assume 15 percent of the nonfederal costs for Medi-Cal services. Currently, these costs are shared almost equally by the state and federal governments with no county financial participation. In addition, the Budget proposes to shift the cost of nursing home stays under the Medi-Cal Long-Term Care Benefit to the counties. These two proposals will increase the annual costs to counties by over \$3 billion, and are intended to be funded with tax increases that will create an ongoing stream of revenue.
- **Program Expansions – Continued Funding.** The Budget proposes \$486.6 million (\$243.3 General Fund) to provide 12 months of Continuous Eligibility for 471,500 children. The Budget also includes \$20.8 million (\$10.4 million General Fund) to fund Accelerated Enrollment through the Single Point-of-Entry, which will entitle 67,700 children to fee-for-service, full-scope, no-cost Medi-Cal on a presumptive eligibility basis. The Budget further proposes \$283.9 million (\$137.1 million General Fund) to have the Child Health Disability Prevention (CHDP) Program serve as a Gateway for enrolling children into either the Healthy Families Program or Medi-Cal. The CHDP Gateway effort will be facilitated by two additional Express Lane Eligibility program expansions: (1) 5,850 children receiving free school lunches will automatically be enrolled in Medi-Cal, at a budget-year cost of \$4.3 million (\$2.1 General Fund); and (2) 11,000 parents and children who receive food stamps will be provided with enrollment materials for Medi-Cal and the Healthy Families Program, for a budget-year cost of \$8.5 million (\$4.2 million General Fund).

Public Health

Expenditures for all public health programs and state support are projected to be \$2.9 billion (\$452.3 million General Fund) in 2003-04. Although this represents a General Fund reduction of \$219 million (32.6 percent) in current-year expenditures, the budget proposes several major augmentations and staffing increases, several of which are to be funded with additional federal grants or special funds. The Budget also proposes some administrative consolidations, program reductions, and the realignment of many public health programs that are important in rural areas of the state.

- **Augmentations.** Additional federal funds of \$15.5 million in the current year and \$84.4 million in the budget year will be used to expand the Women, Infants, and Children's (WIC) Supplemental Nutrition Program to serve another 24,000 persons. An increase of \$1.7

million in federal funds will back-fill Proposition 99 funding support for the Breast and Cervical Cancer Control Program. The Department of Health Services will receive \$112.3 million under Proposition 50 to fund its activities related to the Water Security, Clean Drinking Water, Coastal, and Beach Protection Act of 2002. The Asthma Initiative will be continued with \$2.8 million in reimbursements and four staff positions. The Department of Health Services will also add eight new positions and spend \$439,000 General Fund and \$282,000 federal funds to implement a drug rebate program for the California Children's Services (CCS) Program and the Genetically Handicapped Persons Program (GHPP). The Budget assumes the new rebate program will result in General Fund savings of \$3.6 million in 2003-04. The Budget also proposes an increase of \$8.3 million General Fund for the AIDS Drug Assistance Program (ADAP) as well as a new co-payment requirement for ADAP recipients with incomes between 200 and 400 percent of the federal poverty level (i.e., those with annual incomes of \$21,643 to \$30,233 will pay \$1,299 to \$1,814 for medications).

- **Consolidations.** The Administration will propose legislation to eliminate the Emergency Medical Services Authority (EMSA) as a separate entity and to transfer its functions to the Department of Health Services, for budget-year savings of \$342,000 (\$138,000 General Fund) and the elimination of five staff positions. The Budget also proposes to consolidate all domestic violence shelter programs in one agency, the Department of Health Services. As a result, \$730,000 General Fund and \$9.1 million federal funds will be transferred from the Office of Criminal Justice Planning (OCJP) to the Department of Health Services, which will provide a total of \$32.5 million for allocation to local shelters during 2003-04.
- **Reductions.** The Budget proposes to eliminate all state funding for cancer research, for budget-year savings of \$12.5 million, and to reduce state funding for the Prostate Cancer Treatment Program by \$15 million. (The Governor's Mid-year Spending Reduction Proposals package proposes reductions in both of these programs, for current-year savings of \$6.3 million and \$10 million respectively).
- **Realignment.** Under the Governor's Healthy Communities Realignment proposal, the Budget assumes the shifting of responsibility for the following programs to the counties: Adolescent Family Life, Black Infant Health, Indian Health, Local Health Department Maternal and Child Health, Expanded Access to Primary Care, Grants-in-Aid for Clinics, Rural Health Services Development, Seasonal Agricultural and Migratory Workers, County Health Managed Care, California Healthcare for Indigents, Rural Health Services, and the Public Health Subvention. The cost of the programs being realigned is approximately \$143.4 million (\$66.6 million General Fund), and counties will continue to receive Proposition 99 funds and matching federal funds. State costs shifted to the counties are intended to be funded with tax increases that will create an ongoing stream of revenue.

Healthy Families Program

If the budget projections are correct, total expenditures for the Healthy Families Program have grown by 298 percent in the five years since the Program was established. In fiscal year 1999-00, program expenditures were \$211.8 million (\$76.2 million General Fund), and the Budget

proposes \$809.7 million (\$303.6 million state funding) for 2003-04. The caseload is expected to grow to 768,000 children. The Administration is proposing to delay expansion of the Program to parents of eligible children until July 2006.

The Budget continues to fund the Healthy Families Program as though it were an entitlement and, therefore, projects expenditures for the maximum caseload possible. Historically, this Budget has been over-funded each year because enrollments have not matched projections.

Mental Health

The Budget includes \$2.3 billion (\$786.8 million General Fund) for state hospitals and community mental health programs. Significant changes to the Mental Health budget include some program reductions of concern, the realignment of two programs, and a rather large increase in expenditures for Early and Periodic Screening, Diagnosis, and Treatment (EPSDT) services.

- **Program Reductions.** The Budget proposes to eliminate the Early Mental Health Services Program, for General Fund savings of \$15 million. In addition, a 10 percent rate reduction to mental health managed care is proposed, for budget-year savings of \$46 million (\$23 million General Fund).
- **Realignment.** The Budget proposes to realign the Integrated Services for the Homeless and Children's System of Care Programs. Annual costs to counties will increase by \$75 million. State costs shifted to the counties are intended to be funded with tax increases that will create an ongoing stream of revenue.
- **EPSDT.** The Budget includes an increase of \$230.4 million (reimbursements), which represents a 42.4 percent increase in program costs over the past year. It is unclear what factors are generating this huge increase and whether or not cost control measures will be effective.

Developmental Disabilities

The Budget includes \$3.2 billion (\$2 billion General Fund) to serve developmentally disabled persons in the community through the 21 Regional Centers or in one of the state developmental centers. Two major policy changes will have significant effects on the 2003-04 budget.

- **Policy Changes.** The Budget assumes that \$31.6 million in revenues will be achieved with the implementation of a proposal to require parents to share in the cost of providing services to their developmentally disabled, minor children living at home. This will affect families earning more than 200 percent of the federal poverty level. The Department of Developmental Services will spend \$1.8 million and add 23.6 new staff positions to implement this program. The other significant policy change is the Administration's proposal to redefine the state's definition of "substantial disability" so that it aligns with the federal eligibility definition. Persons currently eligible for services would continue to receive services; however, the new definition would be applied prospectively and is expected to

generate \$2.1 million in General Fund savings in the budget year because fewer persons would qualify for services in the future.

- **Implementation of Statewide Standards.** The Budget assumes a \$100 million General Fund savings will be achieved if the Regional Centers are required to implement statewide standards for the delivery of services. The Administration has not submitted any proposals that would reduce or eliminate the Lanterman entitlement.
- **Projected Closure of Agnews Developmental Center.** The Department of Developmental Services plans to close this facility by July 2005. Any remaining residents will be placed in the community or transferred to another developmental center. During the budget year, the total caseload for all developmental centers is expected to decline by 70 persons, to 3,590 individuals.
- **Consolidation.** The Budget proposes the transfer of the Habilitation Services Program from the Department of Rehabilitation to the Department of Developmental Services, which is expected to result in a net General Fund savings of \$1.5 million and the elimination of 11 staff positions.

Fee Increase - Family Physician Training Program

The Office of Statewide Health Planning and Development administers the Family Physician Training Program. The Administration is proposing legislation to impose a surcharge on various medical licenses to fund this program. This fee revenue would backfill \$4.5 million in General Fund costs.

HUMAN SERVICES

Alcohol and Drug Programs

The Budget includes \$483.1 million (\$5.6 million General Fund) for alcohol and drug programs in 2003-04, reflecting a \$94.6 million (\$231.1 million General Fund) decrease from 2002-03.

- **Realignment.** The Budget proposes to transfer to counties in 2003-04 Drug Medi-Cal services, drug court programs, Proposition 36 funding, and non-Medi-Cal alcohol and drug services. The realignment would generate an estimated \$231 million state General Fund savings and \$230 million in additional costs to counties.
- **New Positions.** The Budget adds 2.5 positions and \$3.942 million in 2002-03 and 9 positions and \$4.894 million in 2003-04 to administer several programs. The affected programs include the Federal State Incentive Grant, Performance Partnership Grants, Narcotic Treatment Program Licensing, and Proposition 36 Licensing and Certification. Although many of the new positions are federally funded, the establishment of new positions increases the size of an already excessive state bureaucracy. Further, if the Governor extends his current hiring freeze beyond June 30, 2003, the Department of

Alcohol and Drug Programs may experience significant difficulty in filling the positions and may eventually lose them anyway.

Child Support Services

The 2003-04 Budget proposes \$1.2 billion (\$470.2 million General Fund) for child support services.

- **Automated System Penalties.** The Budget proposes \$188.2 million General Fund in 2002-03 and \$207.1 million General Fund in 2003-04 to pay federal penalties because the state failed to implement a single, statewide automated child support system. The \$188.2 million penalty reflects a \$98.5 million increase over the original amount appropriated in the 2002 Budget Act. The Budget also proposes legislation that requires counties to pay 25 percent (\$6.2 million) of the fourth quarter portion (\$24.6 million) of the 2002-03 increased penalty and 25 percent (\$51.8 million) of the entire 2003-04 penalty. The county share of costs would generate 2003-04 savings of \$51.8 million General Fund. It is unclear at this time whether counties should share in taking responsibility for the state's failure.

Welfare-to-Work

The Budget provides \$6.7 billion for California Work Opportunity and Responsibility to Kids (CalWORKS) programs, including \$5.8 billion for direct programs, \$598 million for other programs, and \$200 million for a reserve. The funding consists of \$3.7 billion in federal funds from the federal Temporary Assistance to Needy Families (TANF) grant, \$2.7 billion state General Fund, and \$300 million federal TANF funds available from previous years.

The Budget indicates that caseload growth is continuing to flatten after many consecutive years of decline. Estimated CalWORKS caseload for 2003-04 is 514,000 cases, an increase of 3,000 from 2002-03. The Department of Social Services believes that the increase is due to the state's recent economic downturn.

- **Cost-of-Living Adjustment (COLA) Suspensions and Grant Reductions.** The Budget does not include funding to provide a COLA for cash grants. In addition, the proposal reduces grant levels by 6 percent, consistent with the proposed reduction to the Supplemental Security Income/State Supplementary Payment grant. The reduction would free up \$65.7 million federal TANF funds for transfer to the Department of Developmental Services (DDS), to generate commensurate General Fund savings in that department. Despite the reduction, grant levels are still higher than they were at the start of the Governor's first term.
- **Realignment.** The Budget proposes to transfer 50 percent of total program costs to counties for CalWORKS Employment Services, CalWORKS Administration, CalLearn Services and Administration, Food Stamp Administration, and the Food Stamp Employment and Training Program. The realignment would generate and estimate \$826 million in state General Fund savings and an equal amount in additional costs to counties.

- **TANF Reauthorization and Reserve.** The Budget includes a \$200 million federal TANF fund reserve to mitigate the unanticipated impact of program pressures, including federal reauthorization of the TANF program. The Budget indicates that the latest federal legislative proposals for reauthorization would increase work participation requirements, resulting in additional spending on employment services. An increase in federal work participation requirements does not automatically “require” more spending on discretionary employment services at the state level. However, if California fails to meet revised work participation requirements, the state maintenance-of-effort spending requirement would increase and the federal TANF grant would decrease. Therefore, fewer federal funds would be available and state General Fund expenditures would grow.

Supplemental Security Income/State Supplementary Payment (SSI/SSP)

The Budget proposes \$2.3 billion for SSI/SSP in 2003-04, a 24.2 percent decrease from 2002-03. The Budget estimates 1.1 million cases in 2003-04, an increase of 0.7 percent over 2002-03. The caseload consists of 68 percent disabled, 30 percent aged, 2 percent blind persons.

- **COLA Suspensions and Grant Reductions.** The Budget suspends the June 2003 (3.74 percent) and January 2004 (3.48 percent) state COLAs for SSI/SSP grants. The Budget also reduces the SSI/SSP grant to the federally required maintenance-of-effort spending level. Overall grant payments decrease from \$757 to \$708 for an individual and from \$1,344 to \$1,225 for a couple. However, the Budget includes the January 2004 COLA of 2.4 percent, increasing grants to \$722 for individuals and \$1,244 for couples. California continues to provide the highest level of support to SSI/SSP recipients among the ten most populous states.
- **Realignment.** The Budget proposes to transfer to counties 100 percent program responsibility for the Cash Assistance Program for Immigrants, generating estimated state General Fund savings of \$95 million and increase county costs by the same amount.

In-Home Supportive Services (IHSS)

- **Provider Rate Increases.** The Budget includes \$2.8 million General Fund to provide an average 16 percent increase in Maximum Allowable Contract Rates and \$20.5 million General Fund to provide a \$1 per hour increase in the state share of the maximum rate for Public Authority providers of IHSS services.
- **Realignment.** The Governor proposes to transfer to counties responsibility for 100 percent of state program costs. The realignment would generate an estimated \$1.171 billion in state General Fund savings and a commensurate amount of costs to counties.

Community Care Licensing

The Budget provides \$115.7 million (\$37.5 million General Fund) for licensing facilities that serve 1.4 million clients. The funding level reflects a \$10.5 million (\$7.6 million General Fund) decrease from 2002-03.

- **Streamlined Facility Reviews.** The Budget includes savings of \$7.6 million (\$5.8 million General Fund) and elimination of 62 positions due to streamlining annual reviews of licensed care facilities.
- **Fee Increases.** The Budget increases fees for licensed facilities to generate an estimated \$6.8 million in General Fund revenues. The proposal would double fees for licensed child care facilities, assess a \$45 fee on foster family agencies for each certified family home that agencies oversee, and increase fees by 25 percent for all other licensed child residential, adult care, and senior care facilities. The revenues generated by the fee increase would help to reduce the program's General Fund need, resulting in the noted \$10.5 million General Fund savings. It is unclear why program expenditures decrease by \$10.5 million when a fee increase would generate \$6.8 million in General Fund revenues.

Information Technology/Data Management

- **Statewide Automated Welfare System Funding Increases.** The Budget includes a \$10.9 million (\$4.7 million General Fund) increase in 2003-04 for the Welfare Client Data System. Despite the increase, system completion would be delayed by one year. In addition, the Budget provides a \$7.9 million (\$2.9 million General Fund) increase for the Los Angeles Eligibility, Automated Determination, Evaluation, and Reporting System.
- **Other System Funding Increases.** The Budget increases funding by \$48.4 million (\$22.4 million General Fund) and adds 6 new limited-term positions for several other automation projects, including the Child Welfare Services/Case Management System; CalWORKS and Food Stamps Electronic Benefit Transfer System; Case Management, Information, and Payrolling System. Increasing General Fund expenditures for existing systems is questionable when other state programs are experiencing significant General Fund cuts. In addition, the establishment of new positions increases the size of an already excessive state bureaucracy. Further, if the Governor extends his current hiring freeze beyond June 30, 2003, the Health and Human Services Data Center may experience significant difficulty in filling the positions before they expire.

Child Welfare

- **Realignment.** The 2003-04 Budget proposes to shift responsibility to counties for 100 percent of state program costs for Foster Care, Child Welfare Services, and Adoptions and Assistance. The entire Child Abuse Prevention, Intervention, and Treatment program would also shift to counties. The realignment would generate estimated state General Fund savings of \$1.339 billion and commensurate costs for counties.

K-12 EDUCATION

Proposition 98 Overview

As the table below shows, the Budget proposes total Prop. 98 funding for 2003-04 of \$44.1 billion. This funding level for K-12 and community colleges consists of \$28.2 billion General Fund and \$15.9 billion local property tax and reflects a \$2.4 billion Prop. 98 decrease from the amount in the 2002-03 Budget Act. The Budget proposes \$4.1 billion for community colleges in 2003-04 – only 9.2 percent of total Prop. 98 spending and almost \$500 million less than if they had received the same percentage as in 2002-03. Over the long term, over \$3.5 billion of so-called “maintenance factor” funding, of which this \$900 million is a part, will have to be restored to K-12 schools and community colleges.

Proposition 98 and Per Pupil Funding				
<i>(\$ in billions except for per pupil expenditures)</i>	2001-02 Revised	2002-03 Budget Act	2002-03 as Proposed in Budget	2003-04 as Proposed in Budget
Prop. 98 Total	\$43.2	\$46.5	\$43.9	\$44.1
Prop. 98 Gen. Fund	(\$29.5)	(\$31.6)	(\$28.9)	(\$28.2)
K-12 Prop. 98	\$38.4	\$41.6	\$39.3	\$39.9
CCC Prop. 98	\$4.4	\$4.8	\$4.5	\$4.1
Prop. 98 \$ per Pupil	\$6,610	\$7,067	\$6,536	\$6,708
Total \$ per Pupil	\$6,683	\$9,477	\$9,072	\$8,899

K-12 Programs

Under the Budget proposal, Prop. 98 expenditures per K-12 pupil will drop from \$7,067 per pupil in the 2002-03 Budget Act to \$6,708 per pupil proposed for 2003-04 – a 5 percent cut. Total per pupil spending – including state, local, and federal funds – is proposed at \$8,899.

For K-12 education, the Budget makes a number of significant budget proposals:

- Cutting general-purpose apportionments and categorical programs 3.66 percent in the current year (per the December Mid-year Spending Reduction Proposal), saving \$980.6 million in the current year.
- Cutting funding for most categorical programs by an additional 7.46 percent in the current year, for an additional \$481.7 million savings, and carrying over the categorical cuts into the budget year for an 11 percent cut and a \$1.6 billion savings in 2003-04.
- Consolidating 64 (nearly all) categorical programs into a single \$5.1 billion block grant to be used as local school district governing boards deem appropriate for their communities. All associated statutory requirements would be eliminated as well, except for that governing the 13 remaining categoricals, such as special education, testing and accountability, summer school, and class size reduction. The State Department of Education is proposed to lose 92.2 personnel years and \$6.7 million associated with the elimination of the categorical programs.

- Providing \$358.7 billion for school district apportionments in 2003-04 to fund a 1.0 percent increase in enrollment, as required by statute.
- Not providing statutory growth funding for categorical programs, for a \$104.8 million savings.
- Not providing the statutorily-required 1.55 percent COLA for both apportionments and categorical programs, for a \$800.5 million savings.
- Not providing \$156 million for equalization, thus funding only \$250 million of the \$406 million that is necessary to complete full equalization.
- Eliminating CalWorks Stage 3 childcare in the current year for an ongoing \$98.8 million savings beginning in 2002-03 and an additional \$39 million savings in the 2003-04 that would have been provided to fund Stage 3 growth.
- The 2003-04 Budget proposes to shift child care to counties, generating estimated General Fund savings of \$968 million and county costs of \$1.031 billion. The affected programs include General Child Care, Alternative payment Programs, CalWORKS Stage 2 and Stage 3 Child Care, and other programs.

California State Library

The Budget proposes cutting state General Fund support to local public libraries to \$15.8 million in the both the current year and the budget year, a 50 percent reduction from the 2002-03 Budget Act and a 72 percent reduction from the \$56.9 million provided in 2000-01.

HIGHER EDUCATION

The Budget proposes no funding increases under the Higher Education Partnership Agreement for the University of California (UC) and the California State University (CSU) agreed to by the Governor in the Partnership negotiated in the spring of 2000. The Partnership had promised 5 percent annual increases. Overall, the Budget proposes base reductions to UC of \$373 million and to CSU of \$326 million, while community colleges would see a \$404 million cut. The Administration intends these reductions to be offset in part by the UC Regents, CSU Trustees, and legislature raising student fees, as displayed in the table below.

Annual Fees and Proposed Increases for Full-Time Resident Undergraduate Students						
<i>(whole dollars, except for last column)</i>	2001-02	2002-03	2003-04	Amount of Increase	Percentage Increase	Revenue Generated*
Community Colleges	\$330	\$390	\$720	\$390	118%	\$149 million
California State University	\$1,428	\$1,572	\$1,968	\$540	38%	\$303 million
University of California	\$3,429	\$3,564	\$4,629	\$1,200	35%	\$394 million
*/ For UC and CSU, total revenue generated also includes nonresident, graduate, and professional fee increases.						

University of California

The Budget proposes \$4.5 billion (including \$3 billion General Fund) for UC in 2003-04. This represents a net increase of \$112 million (2.5 percent) over the revised current year funding levels, and includes anticipated fee increases.

Major funding increases include:

- \$117.2 million to fund enrollment growth of 4.5 percent (8,000 students)
- \$24.4 million for lease-revenue debt payment
- \$11.3 million for UC Merced startup costs

The major reductions include:

- \$214 million in unallocated base reductions over the current year and budget year
- \$33 million from outreach programs
- \$29 million from a variety of research programs

California State University

The Budget proposes \$3.6 billion (including \$2.6 billion General Fund) for the CSU in 2003-04. This represents an increase of \$88.3 million (2.5 percent) over the revised current year funding levels, and includes anticipated fee increases.

Major funding increases include:

- \$150.9 million to fund enrollment growth of 5.0 percent (16,056 students in 2003-04 and an additional unanticipated 8,000 students in 2002-03).

- \$1.1 million for lease-revenue debt payment

The major reductions include:

- \$143 million in unallocated base reductions over the current year and budget year
- \$53 million by increasing the faculty-to-student ratio from 18.9 to 1 to 19.9 to 1
- \$13 million from outreach programs
- \$4 million by eliminating the Cal Teach recruitment program (\$2 million) and the Bilingual Teacher Recruitment Program (\$2 million)
- \$1.4 million from the Student Fellows Program

California Community Colleges

The Budget includes \$6.1 billion (\$4.1 billion Proposition 98 funds, including \$1.9 billion General Fund) for community colleges to serve an estimated 1.072 million full-time equivalent (FTE) students in 2003-04. The enrollment estimate shows a net decrease of 65,000 FTE students compared to 2002-03. The funding reflects a \$97.5 million (3.66 percent) reduction continued from 2002-03 (Governor's Mid-year Spending Reduction Proposal) and a \$271.8 million reduction to categorical programs.

Fee Increase. The Budget proposes to increase fees from \$11 per unit to \$24 per unit in 2003-04, generating an estimated \$149 million in General Fund savings. According to Community Colleges, the 65,000-student decrease in enrollment partially results from past increases in fees. The proposed fee increase would further reduce enrollment in Community Colleges.

Student Aid Commission

Based on statutory requirements and costs associated with higher education fee increases, the Budget proposes to increase Cal Grant funding to \$658.7 million in 2003-04, an \$82 million increase over the current year. To mitigate further increased costs, the Budget proposes the following savings from student aid programs:

- \$10 million by reducing new Cal Grant A and B awards to students attending private colleges by 9 percent, resulting in a maximum award amount of \$8,832.
- \$5 million by eliminating state work-study programs
- \$4 million by reducing the number of Cal Grant C awards (for vocational college students) from 10,730 to 7,690.
- \$3 million by reducing the number of Cal Grant T awards (for teacher credential students) from 1,390 to 850.

California Postsecondary Education Commission

The Budget proposes reducing the California Postsecondary Education Commission (CPEC) budget to \$695,000 General Fund and 4.5 positions. This nearly eliminates CPEC, which in 2001-02 had a General Fund budget of \$3.6 million and 43.6 positions.

PUBLIC SAFETY AND JUDICIARY

Judiciary

The 2003-04 Judicial budget (Supreme Court, Court of Appeals, Administrative Office of the Courts, and the Habeas Corpus Resource Center) totals \$344.8 million, which includes \$284.3 million in state operations and \$60.5 million in local assistance. The proposed budget includes the following adjustments:

- The Budget proposes a General Fund augmentation of \$635,000 for activities related to the implementation of the Trial Court Interpreter Labor and Employee Relations Act (Ch. 1047/02).
- The Budget proposes an unallocated General Fund reduction of \$8.5 million in 2002-03 and \$17.7 million in 2003-04. The Judicial Council is working on a plan to allocate these reductions among their various programs and will present the plan to the Legislature in the Spring.
- The Budget proposes a General Fund savings of \$500,000 related to the consolidation of various administrative functions at the Courts of Appeal.

In addition, the Administration will propose legislation in the 2003-04 First Extraordinary Session to **increase the appellate filing fee from \$265 to \$630**, effective July 1, 2003. The Administration estimates that this fee increase will generate \$2.1 million in General Fund revenues annually.

Trial Courts

The Trial Court Funding budget proposes \$2.2 billion (\$791 million General Fund and \$1.4 billion in various special funds) for State Trial Courts in 2003-04, which reflects an overall decrease of approximately \$5.2 million over the revised current year. The proposed budget includes the following adjustments:

- The Budget proposes an augmentation of \$32.6 million from the Trial Court Trust Fund to address increased costs associated with providing security at trial court facilities. In addition, the Budget reflects a saving of \$22 million (General Fund) related to pending legislation that will provide the courts with increased flexibility to contract for court security.

Additionally, **the Budget proposes to deposit \$300 million of the \$8.33 billion in new Realignment Revenue into the Trial Court Trust Fund for court security.** This revenue source will fund the existing base level of court security (\$289 million less \$22 million saved

through the court flexibility proposal and the augmentation of \$33 million for increased security costs discussed above). If the Realignment proposal is adopted, the combination of these actions will have the net effect of reducing General Fund expenditures in the Trial Court Budget by \$300 million.

- The Budget proposes an unallocated General Fund reduction of \$36 million in 2002-03 and \$116 million in 2003-04. The Judicial Council is working on a plan to allocate these reductions among the various trial court programs and will present the plan to the Legislature in the Spring.
- The Budget proposes a General Fund savings of \$31 million as a result of pending legislation to implement electronic reporting of court proceedings.
- The Budget proposes a General Fund saving of \$5.5 million related to court ownership of court reporting transcripts as a result of implementing the pending electronic reporting legislation.
- The Budget proposes a General Fund saving of \$2.5 million related to the pending legislation that will consolidate various administrative functions at the trial courts.
- The Budget proposes a General Fund augmentation of \$8.4 million in 2002-03 and \$14.3 million in 2003-04 to meet various needs of the trial courts, including health benefit increases.
- The Budget proposes a \$20 million General Fund augmentation for increased retirement costs of trial court employees.
- The Budget proposes a \$4.5 million General Fund augmentation for increased costs associated with providing court interpreters to assist non-English speaking defendants in trial court proceedings.
- The Budget proposes a \$3.9 million General Fund augmentation related to the cost of implementing the Trial Court Interpreter Labor and Employee Relations Act (Ch. 1047/02).
- In addition, the Budget proposes **\$66 million in fee increases** to support the operations of the trial courts, and the revenue from these fees will partially offset the General Fund support currently provided to the trial courts:
 - A security fee of \$20 per court filing is estimated to generate \$34 million annually,
 - Increasing the Trial Motion Fee from \$23 to \$33 will result in revenue of \$1.2 million annually, and
 - Transferring revenues from various undesignated fees on court-related activities from the counties to the courts will generate \$31 million annually.

Commission on Judicial Performance – The Commission’s proposed General Fund budget for 2003-04 totals \$3.1 million, and reflects an unallocated reduction of \$1 million.

Public Safety

California Highway Patrol (CHP)

The CHP is the State’s largest law enforcement agency and patrols over 105,000 miles of state highways and county roads, ensures the safe operation of commercial trucks through inspection at weigh stations, and protects State facilities and its occupants. The CHP’s budget is supported primary from the Motor Vehicle Account (MVA).

As part of the 2002 Budget Act, the CHP received an augmentation of \$81.5 million and 236 positions to protect California’s infrastructure from terrorism. This proposal was funded from the MVA with the expectation that the MVA would be reimbursed with \$75 million in federal anti-terrorism funds. However, in order for the MVA to advance the necessary funds to the CHP, the Administration proposed and the Legislature adopted fee increases that totaled \$30 million in 2002-03 and \$60 million in 2003-04.

The Administration continues to reflect the receipt of over \$169 million in federal anti-terrorism funds in the 2002-03 and 2003-04 fiscal years, but as of the release of the Budget, the State had not receive any of the anticipated funds. As a result, ***the Administration is proposing additional fee increases for 2003-04 of nearly \$194 million in new MVA revenue.*** This proposal is more fully discussed under the Transportation Section.

The CHP’s budget proposes \$1.232 billion in various special funds in 2003-04, which reflects a decrease of approximately \$5 million over the revised current year. While the Budget has not received any significant augmentations or reductions, two significant fund shifts bear mention.

These shifts are:

- A shift of \$16 million from the MVA to the State Highway Account to fully fund eligible, yet undefined costs.
- A shift of \$51 million from the MVA to the State Emergency Telephone Number Account to fully fund 9-1-1 activities performed by the CHP.

Department of Justice

The Budget proposes \$607 million (\$302 million General Fund and \$305 million in various special funds) for the Department of Justice in 2003-04, which reflects a decrease of approximately \$31 million over the revised current year.

The major proposed adjustments are:

- The Budget proposes a General Fund augmentation of \$10.7 million in 2002-03 and \$4.3 million in 2003-04 to defend the California Youth Authority in a class action lawsuit

challenging the Youth Authority's policies and procedures concerning conditions of ward confinement.

- The Budget proposes a General Fund augmentation of \$9.5 million and 34 personnel years (two-year limited-term) to continue the investigation and litigation of illegal activity that has been determined to be responsible for California's energy crisis.
- The Budget proposes an augmentation of \$2.1 million (\$545,000 General Fund, \$1.6 million federal funds) and 19 personnel years to provide funding for the investigation, arrest, and prosecution of Medi-Cal fraud, elder abuse and neglect, and poor quality of care in federal Medi-Cal funded facilities.
- The Budget proposes a General Fund reduction of \$3 million due to the elimination of the program to assist district attorneys in the vertical prosecution of spousal abuse.
- The Budget proposes a General Fund reduction of \$3 million due to the elimination of grants to support gang prevention activities.
- The Budget proposes a General Fund decrease of \$3.5 million (and a corresponding increase in reimbursement authority) to reflect a proposal to charge local agencies a portion of the costs for processing and analyzing physical evidence in State crime labs.
- The Budget proposes a General Fund reduction of \$12.9 million that is spread across the department's various divisions and programs, including \$5.8 million for external consultant contracts and \$5.9 million in out-of-state travel.

Office of the Inspector General

The Budget proposes \$7.7 million (General Fund) for the Inspector General in 2003-04, which reflects a decrease of approximately \$1.1 million over the revised current year.

The major proposed adjustments are:

- The Budget proposes a reduction of \$449,000 and five personnel years to reflect reductions to the number of management review audits performed by the Inspector General.
- The Budget proposes a reduction of \$1 million and ten personnel years to reflect reductions to investigations of complaints of intentional engagement in an act of reprisal, retaliation, threat, or coercion from an employee of the Youth and Adult Correctional Agency.
- The Budget proposes a reduction of \$330,000 and four personnel years to reflect reductions to administrative positions commensurate with the reductions in audits and investigations.

Commission on Peace Officers Standards and Training (POST)

The Budget proposes \$28.7 million in special fund and reimbursements for the Commission in 2003-04, which reflects a decrease of approximately \$23.7 million over the revised current year.

The major adjustment is:

- The Budget proposes a transfer of \$28.3 million from the Peace Officers' Training Fund to the General Fund due to the elimination of a program that partially reimburses local law enforcement agencies for the cost of student travel and per diem and reimbursement of overtime to replace line officers during training.

Office of Criminal Justice Planning

The Budget proposes \$254 million (\$65 million General Fund and \$189 million in various special funds) for the Office of Criminal Justice Planning in 2003-04, which reflects a decrease of approximately \$12 million over the revised current year.

The major proposed adjustments are:

- The Budget proposes a transfer of \$9.5 million (\$730,000 General Fund and \$8.8 million federal fund) in local assistance funding to the Department of Health Services to consolidate all domestic violence programs within one agency.
- The Budget proposes a Federal Fund reduction of \$359,000 and 1.4 positions associated with the transfer.
- Consistent with the Governor's Mid-year spending reduction proposals, the Budget proposes a General Fund reduction of \$3.4 million associated with the following public safety local assistance programs, as well as a General Fund reduction of \$214,000 associated with various victims services local assistance programs:
 - \$1,600,000 – Vertical Prosecution of Statutory Rape Program
 - \$ 200,000 – Rural Crime Prevention Program
 - \$ 230,000 – California Community Crime Resistance Program
 - \$ 350,000 – CA. Career Criminal Prosecution Program
 - \$ 288,000 – CA. Career Criminal Apprehension Program
 - \$ 136,000 – Serious Habitual Offenders Program
 - \$ 174,000 – Vertical Defense of Indigents Program
 - \$ 236,000 – Gang Violence Suppression Program
 - \$ 34,000 – Evidentiary Medical Training Program
 - \$ 78,000 – Suppression of Drug Abuse in Schools Program
 - \$ 31,000 – Multi-Agency Gang Enforcement Consortium Program
 - \$ 6,000 – Public Prosecutors and Defenders Training Program

- The Budget proposes a General Fund reduction of \$319,000 and two positions related to reductions in various administrative activities.

Department of Corrections

The Budget proposes \$5.3 billion (\$5.1 billion General Fund and \$200 million in various special funds and reimbursement authority) for the Department of Corrections (CDC) in 2003-04, which reflects an increase of approximately \$40 million (\$53 million General Fund and a \$16 million reduction in reimbursement authority) over the revised current year.

CDC's inmate population is projected to increase from 160,661 on June 30, 2003, to 161,039 by June 30, 2004, an increase of 378 inmates. The parole population is projected to decrease from 117,233 on June 30, 2003, to 115,387 by June 30, 2004, a decrease of 1,846 parolees.

The major proposed adjustments are:

- The Budget proposes a \$46.2 million General Fund reduction for the academic and vocational education budgets.
- The Budget proposes a General Fund reduction of \$1.5 million and 79 personnel years in 2002-03 and \$10.2 million and 242 personnel years in 2003-04 due to the closure of the Northern California Women's Facility, which will be converted and reopened as a male reception center in 2004-05.
- The Budget proposes a General Fund reduction of \$578,000 in 2002-03 and \$2.6 million and one personnel year in 2003-04 by eliminating the Arts in Corrections Program, an instructional arts program that uses professional artists to teach inmates art.
- The Budget proposes a General Fund augmentation of \$5.5 million and 75 personnel years to establish standardized staffing at authorized Administrative Segregation Units statewide.
- The Budget proposes a General Fund augmentation of \$884,000 and 12 personnel years in order to remain in compliance with court mandates to provide continued custody supervision and programming for mentally ill inmates.
- The Budget proposes a General Fund augmentation of \$21.1 million and 114 personnel years in 2002-03 and \$14.7 million and 327 personnel years in 2003-04 to provide sick leave relief in line with usage patterns for posted positions.
- The Budget proposes a General Fund augmentation of \$604,000 and nine personnel years to provide additional security to control the violence of condemned inmates.
- The Budget proposes a General Fund augmentation of \$5.4 million and nine personnel years for a 500-bed expansion of the Substance Abuse Treatment Program, increasing the total budgeted substance abuse beds statewide to 9,001.

- The Budget proposes a General Fund augmentation of \$32.8 million in 2002-03 and \$115.8 million in 2003-04 for increased workers' compensation expenditures.
- The Budget proposes a General Fund increase of \$2.4 million in 2002-03 and \$6.7 million in 2003-04 for the operational impacts of the most recent collective bargaining agreements.
- The Budget proposes a General Fund augmentation of \$1.3 million and five personnel years (two-year limited-term) in order to develop a plan for the replacement of several automated and manual systems used to manage offenders.
- The Budget proposes a General Fund augmentation of \$12.9 million in 2002-03 and \$9.7 million in 2003-04 for projected utilities cost increases.
- The Budget proposes a General Fund augmentation of \$4.2 million and 36 personnel years for additional clinical and support staff to provide additional mental health crisis beds for mentally ill inmates.
- The Budget proposes \$220 million in Lease-Revenue bonds to fund the plans, working drawings and construction of a new Condemned Inmate Housing Complex at California State Prison, San Quentin.

Department of the Youth Authority

The Budget proposes \$414 million (\$337 million General Fund and \$77 million in various special funds and reimbursement authority) for the Department of the Youth Authority (YA) in 2003-04, which reflects a net decrease of approximately \$12 million and a General Fund decrease of approximately \$18 million over the revised current year.

YA's youthful offender (ward) population is projected to decrease from 5,340 on June 30, 2003, to 5,095 by June 30, 2004, a decrease of 245 wards. The parole population is projected to decrease from 4,040 on June 30, 2003, to 3,830 by June 30, 2004, a decrease of 210 cases.

The major proposed adjustments include:

- The Budget proposes a General Fund reduction of \$7.1 million and a commensurate increase in reimbursement authority due to pending legislation to implement an inflation adjustment to the sliding scale fee that the YA charges to counties for various juvenile commitments.
- The Budget proposes a General Fund augmentation of \$675,000 and 10 personnel years in 2002-03 and \$1.5 million and 18 personnel years in 2003-04 for staff and resources to facilitate the implementation of Correctional Treatment Centers at the YA.
- The Budget proposes a \$1.2 million General Fund augmentation to meet the federal Office of Civil Rights standards for English Language Learner students.

- The Budget proposes a \$500,000 General Fund augmentation to begin the design, construction, and alteration of YA facilities to comply with ADA standards and guidelines.
- The Budget proposes a \$1.3 million General Fund augmentation to continue the Infrastructure Migration Project as the YA transitions to an industry standard operating system.
- Consistent with the Mid-year Spending Reduction proposals, The Budget proposes a General Fund reduction of \$844,000 and one personnel year in 2002-03 and \$3.4 million and one personnel year to reimburse the Department of Mental Health to staff and equip a 20-bed inpatient Intermediate Care Facility at the Southern Youth Correctional Reception Center and Clinic.
- The Budget proposes a General Fund reduction of \$6.7 million and sixty personnel years spread over the various institutions and paroles and administration programs.

Board of Prison Terms

The Budget proposes \$28.8 million in General Fund for the Board in 2003-04, which reflects a decrease of approximately \$2.2 million over the revised current year.

The major proposed adjustments include:

- The Budget proposes an augmentation of \$1.4 million and eight personnel years in 2002-03 and \$675,000 and five personnel years in 2003-04 to address a projected increase in parole revocation workload.
- The Budget proposes a redirection of \$1.1 million and 12 personnel years to the Department of Corrections associated with the transfer of responsibility for Proposition 36 referrals to drug treatment.
- The Budget proposes a reduction of \$1 million and five personnel years to reflect a reduction in the number of hearings conducted by Deputy Commissioners in the Offender Screening Section.

Board of Corrections

The Budget proposes \$132 million (\$45 million General Fund and \$87 million in special and federal funds and reimbursement authority) for the Board in 2003-04, which reflects a net increase of approximately \$3 million over the revised current year (\$32 million General Fund reduction, \$18 million Correctional Training Fund reduction and \$51 million federal fund increase).

The major proposed adjustments are:

- The Budget proposes a \$50 million Federal Fund augmentation to administer the Violent Offender Incarceration / Truth-in-Sentencing grant.
- The Budget proposes a \$17 million transfer from the Correctional Training Fund (CTF) to the General Fund due to the elimination of partial reimbursement for tuition, travel, per diem, and staff replacement costs for training local correctional officers. The portion of local correctional officer training costs currently paid for by the State will now become the responsibility of local correctional agencies.
- In addition, the Budget proposes a redirection of approximately \$7 million from the CTF to the General Fund by eliminating the annual transfer of these funds from the Driver Training Penalty Assessment Fund via Control Section 24.10 in the annual Budget Act, and transferring \$10 million directly from the CTF reserve. In total, the Budget proposes to transfer \$34 million from the CTF to the General Fund.

Incarceration of Undocumented Felons

The Budget continues to assume that the State will receive approximately \$155 million in federal State Criminal Alien Assistance Program funding for the 2002-03 and 2003-04 fiscal years. These federal funds are for the partial reimbursement of the costs associated with the incarceration of the undocumented felon population in prison.

Notwithstanding current budget assumptions, the federal program has recently expired and the President's 2002-03 budget proposed to eliminate funding for this grant. To date, Congress has not restored funding for this program. If the State fails to receive these funds, the projected June 30, 2004 General Fund Reserve (Special Fund For Economic Uncertainty) would be reduced from \$531 million to \$221 million.

TRANSPORTATION

Overview - Governor Abandons Plan for Relieving Traffic Gridlock

Less than three years ago, the Governor enacted his Traffic Congestion Relief Program (TCRP) to alleviate traffic congestion and gridlock on California roads and highways. The program was to be funded with an initial appropriation of approximately \$1.6 billion and annual revenue allocations from the sales tax on gasoline (as stipulated by Prop. 42 of the March 2002 Ballot). However, since enactment of the TCRP, none of the sales tax revenue have been allocated and the initial appropriation of \$1.6 billion has almost entirely been "loaned" back to the General Fund. As shown in the Table below, of the amount committed for transportation, only 60 percent was actually provided in the first year following enactment. As proposed in the Governor's 2003-04 Budget, that amount drops to 6 percent.

Comparison of Funds Committed for Transportation and Actual Funding Provided

(dollars in millions)

	<u>2000-01</u>	<u>2001-02</u>	<u>2002-03</u>	<u>2003-04</u>
Total Commitment	\$1,595	\$2,273	\$2,951	\$3,629
Total Redirected	0	- 916 ^a	- 2,739 ^b	- 3,417 ^c
Total Available	\$1,595	\$1,357	\$212	\$212
Percent of Committed Funds Remaining	100%	60%	7%	6%

^a Loan to General Fund of \$238 million and delay of sales tax transfer (\$678 million)

^b Cumulative total of \$916 million from prior year plus additional General Fund loan of \$1,045 million, delay of second sales tax transfer (\$678 million), and \$100 million reversion

^c Cumulative total of \$2,739 million from prior year plus delay of Prop. 42 transfer (\$678 million)

Transportation Cuts for 2003-04. The Budget proposes to cut funding for transportation projects by \$1.6 billion, all of which was included in the Governor's Mid-year Spending Reduction Proposals. These cuts are discussed below.

- **\$1.1 billion suspension in Prop. 42 funding.** Enacted by the voters in the March 2002 election, Prop. 42 would dedicate sales tax on gasoline to funding of transportation projects. The Budget proposes to suspend the allocation of \$1.1 billion, and retain the money in the General Fund to be used for non-transportation purposes. Republicans have argued that taxes imposed on gasoline sales ought to be dedicated to transportation projects to alleviate traffic congestion and repair streets and roads. The Legislative Analyst reports that Californians already spend over 530,000 hours a day in traffic at a daily cost of \$12.8 million in wasted time and fuel. With the increasing growth in urban population, this cut in funding will further exacerbate traffic gridlock in California.
- **\$500 million loan forgiveness.** Between the last two years, the General Fund has borrowed \$1.283 billion from the TCRP, with repayments scheduled over a three-year period. The first of these repayments is due on July 1, 2003. However, the Budget proposes to forgive the first repayment of \$500 million. Although the Budget is silent on future repayments, it is unlikely that the TCRP will see a penny in loan repayments.

As a result of reduced workload, the Budget also proposes to eliminate staffing by 1,344.9 personnel years and \$89.2 million. However, the Administration indicates that these positions may be restored at a later time.

Budget Decommissions the TCRP. Besides cutting transportation funding, the Budget proposes to eliminate the TCRP and force the California Transportation Commission (CTC) to absorb these projects into their limited State Transportation Improvement Program (STIP) budget. Essentially, this means funding more transportation projects with fewer dollars. The CTC will convene a workshop with the regional transportation agencies later this month to determine which projects currently underway will have to be dropped. The CTC will then prioritize funding between STIP projects and TCRP projects. It is unclear how many STIP projects will receive funding when pitted against the Governor's pet TCRP projects.

Consolidation of Transportation Agencies

- High Speed Rail Authority, which is responsible for planning the development and implementation of a high-speed inter-city rail service, is proposed to be consolidated with Caltrans for minimal savings.
- Office of Traffic Safety, which is responsible for distribution of federal funds for various educational programs on traffic safety, is proposed to be consolidated with the office of the Secretary for Business, Transportation and Housing, to produce savings of \$135,000.

Fee Increases in the Motor Vehicle Account. The Motor Vehicle Account, or MVA, provides funding for support of the California Highway Patrol and the Department of Motor Vehicles. Over the years, depressed MVA fee collections and escalating retirement costs have resulted in a variety of fee increases on California motorists. Last year, fees were increased by \$76 million for the 2002-03 fiscal year and \$98 million for the 2003-04 fiscal year for late vehicle registration, DUI suspension appeals, driver information requests, and driving tests. Again this year, the Budget proposes to increase fees which are expected to generate \$194 million in additional revenues as identified in the Table below.

\$194 Million in MVA Fee Increases

Annual vehicle registration base fee	\$41 million
Vehicle registration surcharge	\$54 million
Non-commercial driver's license fee	\$30 million
Identification card issuance charge	\$9 million
Penalties for failure to file title documents	\$11 million
Business Partner Automation fee	\$2 million
Various DMV fees	\$16 million
New fee on telephone usage	\$31 million
<hr/>	
Total Fee Increases	\$194 million

In addition to these fee increases, the Budget proposes to shift \$67 million of expenditures to other funds (\$16 million to the State Highway Account; \$51 million to the Emergency Telephone Number Account) to subsidize the cost of the California Highway Patrol.

RESOURCES

Department of Forestry and Fire Protection. The Budget proposes a total of \$603.7 million for CDF in 2003-04 and 5,130 personnel years. Overall, the Budget adjustments include elimination of vacant positions and reductions for staff travel, as well as changes in federal funding. The only significant changes are reductions of:

- \$750,000 General Fund due to the proposed closure of 22 lookout stations; and
- \$795,000 General Fund related to the closure of two airbases.

While these closures will save the General Fund approximately \$1.5 million, the extent of their impact on CDF's fire suppression and detection capabilities is uncertain.

Department of Fish and Game. The Budget proposes \$276.8 million and 2,173 personnel years for DFG in 2003-04. The major proposals are:

- Fee increase of \$4 million for fishing and hunting licenses.
- Elimination of vacant positions for a savings of \$2.9 million.
- Reduced operations at wildlife areas, ecological reserves and hatcheries for a savings of \$3.5 million.

CALFED. The Budget proposes \$582.1 million for the CALFED program. Of this amount \$18.4 million is from the General Fund, \$531.2 million from bond funds and \$32.5 million from various special funds. In his Mid-year Spending Proposals, the Governor proposed to use significant amounts of Prop. 40 and Prop. 50 bond funds in lieu of General Fund. Without prejudice towards the merits of the CALFED program, this proposal to redirect over half-a-billion dollars from bond proceeds reduces the amount of funding available for local water grant programs.

Parks and Recreation. The Budget proposes \$1.026 billion and 3,036 personnel years for DPR in 2003-04. The major proposals are:

- Park fee increase of \$20 million;
- Prop. 40 expenditures of \$594.2 million for local grants, park restoration and infrastructure improvements; and

- Reduction in field office and administrative operations for a total of \$9 million.

ENVIRONMENT

Fee Increases on Businesses. To help close the deficit, the Budget proposes to reduce General Fund expenditures by increasing a variety of regulatory fees on businesses. While these increases would provide some relief to the General Fund, these fee increases, coupled with other tax increases and hikes in workers' compensation and unemployment insurance costs, tend to make California less and less attractive for businesses. The fee increases are as follows:

- \$10 million fee increase on stationary sources of air pollution;
- \$13.6 million fee increase on waste discharge;
- \$7.5 million fee increase on mill assessment on the sale of pesticides; and
- \$1.1 million fee increase on pesticide regulation licensing and examination.

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